

APPEALS PRELIMINARY ANALYSIS

[Sharkey, Carol L]

Schedule of Adjustments

Issue No.	Description	Tax Period	Examiner's Adjustment	Appeals Change to Adjustment	Appeals Adjustment
	***SEE BELOW				

I. Disputed Items

Brief Background

Taxpayer, Carol L Sharkey in tax years 2020 and 2021 operated a bookkeeping service business. The business was conducted at her residence. Provided bookkeeping, payroll and tax preparation services for individuals and businesses. Taxpayer also has a S-Corporation business. This case primarily concerns the deductibility of expenses based on substantiation. Taxpayer is in dispute with the proposed adjustment for Car & Truck expenses for tax years 2020 and 2021.

APPEALS ANALYSIS

Discussion & Analysis

Issue #1 – Sch. C1 - Car and Truck Expenses

Summary –

REF	ISSUE No.	DESCRIPTION	PERIOD	PER RETURN	PER EXAM	EXAMINER ADJ	APPEALS CHANGE	APPEALS ADJ
		DISPUTED ITEMS						
	1.	Sch C1 - Car and Truck Expenses	202012	\$ 6,929	\$ 3,465	\$ 3,464	\$ -	\$ 3,464
			202112	\$ 4,396	\$ 2,198	\$ 2,198	\$ -	\$ 2,198

Why does the government propose this/these adjustment(s)?

The government states the following –

“The Government has decreased Schedule C Expenses due to lack of substantiation in accordance with IRC 162, 6001, and 274(d).”

Why does the taxpayer disagree with the government?

The taxpayer states the following –

Disagreed item	Reason why you disagree
Mileage of 7,850 business miles	TP gave est. mileage in testimony and maintenance records for one vehicle w/odometer readings.
	TP also gave actual mileage log showing accurate, legitimate, total miles driven for Sch C business. Personal miles and/or S-Corp miles have no bearing on Sch C miles submitted. Maint.
	record odometer readings are for only 1 car. TP used multiple vehicles to drive for Sch C business

Law –

IRC Section: 162

162(a) In General — There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

Treas. Regs § 1.6001-1 Records

1.6001-1(a) In General. - Except as provided in paragraph (b) of this section, any person subject to tax under Subtitle A of the Code (including a qualified State individual income tax which is treated pursuant to section 6361(a) as if it were imposed by Chapter 1 of Subtitle A), or any person required to file a return of information with respect to income, shall keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by such person in any return of such tax or information.

IRC Section: § 274. Disallowance of certain entertainment, etc., expenses

(d) Substantiation required.--No deduction or credit shall be allowed--

(1) under section 162 or 212 for any traveling expense (including meals and lodging while away from home),

(2) for any expense for gifts, or

(3) with respect to any listed property (as defined in section 280F(d)(4)),

unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating the taxpayer's own statement (A) the amount of such expense or other item, (B) the time and place of the travel or the date and description of the gift, (C) the business purpose of the expense or other item, and (D) the business relationship to the taxpayer of the person receiving the benefit. The Secretary may by regulations provide that some or all of the requirements of the preceding sentence shall not apply in the case of an expense which does not exceed an amount prescribed pursuant to such regulations. This subsection shall not apply to any qualified nonpersonal use vehicle (as defined in subsection (i))

§162; Reg. §1.6001-1, §274(d)

APPEALS ANALYSIS

☞ *Has the taxpayer adequately substantiated business purpose; and provided sufficient documentation to deduct expenses based on Internal Revenue Code Sections 162, and 274(d)?*

The answer is no.

Analysis –

In order to deduct expenses associated with a trade or business the expenses must be **ordinary** and **necessary** for the business.

A taxpayer ordinarily must maintain sufficient records to substantiate the amounts of his or her income and entitlement to any deductions or credits claimed. *Treas. Reg. Section 1.6001-1(a)*.

Treas. Reg. § 1.274–5 Substantiation requirements

(c) Rules of substantiation—(1) In general. Except as otherwise provided in this section and § 1.274–6T, a taxpayer must substantiate each element of an expenditure or use (described in paragraph (b) of this section) by adequate records or by sufficient evidence corroborating his own statement. Section 274(d) contemplates that a taxpayer will maintain and produce such substantiation as will constitute proof of each expenditure or use referred to in section 274. Written evidence has considerably more probative value than oral evidence alone. In addition, the probative value of written evidence is greater the closer in time it relates to the expenditure or use. A contemporaneous log is not required, but a record of the elements of an expenditure or of a business use of listed property made at or near the time of the expenditure or use, supported by sufficient documentary evidence, has a high degree of credibility not present with respect to a statement prepared subsequent thereto when generally there is a lack of accurate recall. Thus, the corroborative evidence required to support a statement not made at or near the time of the expenditure or use must have a high degree of probative value to elevate such statement and evidence to the level of credibility reflected by a record made at or near the time of the expenditure or use supported by sufficient documentary evidence. The substantiation requirements of section 274(d) are designed to encourage taxpayers to maintain the records, together with documentary evidence, as provided in paragraph (c)(2) of this section.

(2) Substantiation by adequate records—(i) In general. To meet the “adequate records” requirements of section 274(d), a taxpayer shall maintain an account book, diary, log, statement of expense, trip sheets, or similar record (as provided in paragraph (c)(2)(ii) of this section), and documentary evidence (as provided in paragraph (c)(2)(iii) of this section) which, in combination, are sufficient to establish each element of an expenditure or use specified in paragraph (b) of this section. It is not necessary to record information in an account book, diary, log, statement of expense, trip sheet, or similar record which duplicates information reflected on a receipt so long as the account book, etc. and receipt complement each other in an orderly manner.

(2) Business use of passenger automobiles and other vehicles. (i) On returns for taxable years beginning after December 31, 1984, taxpayers that claim a deduction or credit with respect to any vehicle are required to answer certain questions providing information about the use of the vehicle. The information required on the tax return relates to mileage (total, business, commuting, and other personal mileage), percentage of business use, date placed in service, use of other vehicles, after-work use, whether the taxpayer has evidence to support the business use claimed on the return, and whether or not the evidence is written.

A taxpayer bears the burden of substantiating any deduction that it claims on its tax return. Reg. §1.6001-1(a) requires a taxpayer to “keep permanent books of account or records, ... as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown ... in any return of such tax or information.” If the IRS challenges the deduction, the taxpayer must offer evidence that the deduction was actually paid or incurred and, if relevant, that the expenses were related to a business purpose. ¹ Absent sufficient evidence of a deductible expense, the deduction will be denied. ² In order to substantiate a deduction, a taxpayer must provide evidence not only of the payment itself but also of the scope or nature of the work and its relationship to a business or for-profit activity. ³

Deductions are a matter of legislative grace and are only allowed upon clear proof of entitlement. *Commissioner v. National Alfalfa Dehydrating & Milling Co.* [74-1 USTC ¶ 9456], 417 U.S. 134, 149, 94 S.Ct. 2129, 2137, 40 L.Ed.2d 717 (1974). ⁴ The consequence of lack of evidence on a material element of the deduction is that the taxpayer's claim is to be rejected. *Burnet v. Houston* [2 USTC ¶ 710], 283 U.S. 223, 51 S.Ct. 413, 75 L.Ed. 991 (1931). ⁵

Taxpayers are obligated to keep sufficient records to establish the amount of tax owing, and thus the amount of the deduction claimed. I.R.C. § 6001; Treas. Reg. § 1.6001-1(a). In the absence of such records, entirely unsupported estimates by the taxpayer are insufficient evidence to allow taxpayer to prevail. *Keiner-Williams Stamping Co. v. United States* [40-1 USTC ¶ 9169], 90 Ct.Cl. 203, 30 F.Supp. 807 (1940).⁶

The burden of proof in a Tax Court case is on the taxpayer. In other words, the taxpayer must prove by a preponderance of the evidence that the IRS's determination, as set forth in the notice of deficiency, is erroneous.

1. *Williams v. United States*, 245 F.2d 559, 560 (5th Cir. 1957). See also *Long v. Commissioner*, 772 F.3d 670 (11th Cir. 2014); *Wakefield v. Commissioner*, T.C. Memo 2015-4; *Humbolt Shelby Holding Corp. v. Commissioner*, T.C. Memo 2014-47.
2. See, e.g., *Green Gas Delaware Statutory Tr. v. Commissioner*, 147 T.C. 1 (2016) (deduction denied; taxpayer failed to provide evidence of legal fees, such as engagement letters, invoices for time billed by attorneys, or correspondence related to legal issues); *Lussy v. Commissioner*, T.C. Memo 2015-35 (deduction denied; taxpayer failed to provide substantiating documentation of legal fees allegedly incurred). See also *Safakish v. Commissioner*, T.C. Memo 2014-242.
3. See, e.g., *Rogers v. Commissioner*, T.C. Memo 2014-141 (record did not substantiate the scope or nature of the work or the relationship between the expenses and the taxpayer claiming the deduction).
4. *Commissioner v. National Alfalfa Dehydrating & Milling Co.* [74-1 USTC ¶ 9456], 417 U.S. 134, 149, 94 S.Ct. 2129, 2137, 40 L.Ed.2d 717 (1974).
5. *Burnet v. Houston* [2 USTC ¶ 710], 283 U.S. 223, 51 S.Ct. 413, 75 L.Ed. 991 (1931).
6. *Keiner-Williams Stamping Co. v. United States* [40-1 USTC ¶ 9169], 90 Ct.Cl. 203, 30 F.Supp. 807 (1940).

APPEALS REVIEW:

- Exam's proposed adjustment for Car & Truck Expenses for tax years 2020 and 2021 includes all adjusted Sch C1 business expenses. Taxpayer's protest specifically address the Car & Truck Expenses disallowed.
- 2020 – Car & Truck Expense: \$6,929
2021 – Car & Truck Expense: \$4,396
- Examiner's Workpaper#505-1 Sch C Expenses states.
 - (a). Car & truck expenses were calculated using standard mileage rate.
 - (b). Taxpayer provided nine service and repair receipts with mileage listed. Receipts dated from 1/19/2018 – 9/19/2023. However, only two of the receipts were dated in 2020 and one was dated in 2021.
 - (c). 2020 mileage log with 15,297 miles on Honda CRV. No mileage log was provided for 2021. Taxpayer did not provide an explanation for personal use of vehicle or to differentiate miles driven for taxpayer's S-Corporation.
 - (d). 2020 mileage log total of 15,297 miles is not consistent with maintenance receipts. Mileage log has daily entries and is not consistent with taxpayer's prior testimony of visiting a client once each week. On the 2020 return, taxpayer stated 12,050 business miles while mileage log listed 15,297 miles. ***Due to these inconsistencies and COVID travel restrictions during 2020, the Service understands some mileage would be a reasonable expense and is willing to allow half of the stated business miles for Schedule C business.*** (Remaining stated business miles are considered as S-corporation miles; difference between stated business miles and total from maintenance receipts is considered personal miles.)

- Examiner calculation – 2020 tax year
2020 miles per return – 12,050
Exam allow ½ of miles per return - 6,025
Std. mileage rate – 57.5%
Allowed deduction - \$3,465
- Examiner calculation – 2021 tax year
2021 miles per return – 7,850
Exam allow ½ of miles per return – 3,925
Std. mileage rate – 56%
Allowed deduction - \$2,198
- Taxpayer’s protest states:

Disagreed item	Reason why you disagree
Mileage of 7,850 business miles	TP gave est. mileage in testimony and maintenance records for one vehicle w/odometer readings.
	TP also gave actual mileage log showing accurate, legitimate, total miles driven for Sch C business. Personal miles and/or S-Corp miles have no bearing on Sch C miles submitted. Maint. record odometer readings are for only 1 car. TP used multiple vehicles to drive for Sch C business

- Taxpayer’s protest does not identify the specific tax year that is in dispute but based on the “Disagreed Item” mileage of 7,850 business miles were for tax year 2021.

NOTE: The stated mileage log and documents for odometer readings verification for tax years 2020 and 2021 were not included with taxpayer’s Appeals request, nor casefile from Examination.

Appeals Preliminary Determination

Issue #1 Sch C1 – Car and Truck: A taxpayer ordinarily must maintain sufficient records to substantiate the amounts of his or her income and entitlement to any deductions or credits claimed. *Treas. Reg. Section 1.6001-1(a).*

The government proposes to allow 50% of the claimed deduction for Car and Truck expenses deducted on taxpayer’s 2020 and 2021 Federal Income Tax returns based on documents provided Taxpayer’s Petition does not include any documents that were previously submitted to the government to verify the deduction taken for Car and Truck expenses. Taxpayer will need to provide the support documents consisting of business mile log and odometer readings. **The government position should be sustained.**

III. Non-Disputed Items

APPEALS ANALYSIS

Discussion & Analysis

Summary –

REF	ISSUE No.	DESCRIPTION	PERIOD	PER RETURN	PER EXAM	EXAMINER ADJ	APPEALS	
							CHANGE	APPEALS ADJ
		NONDISPUTED ITEMS						
	2.	Sch E-Inc/Loss-Prtnrship/S Corps-Passive/Non-Passive	202012	\$ -	\$ 16,778	\$ 16,778	\$ -	\$ 16,778
	3.	SE AGI Adjustment	202012	\$ 1,400	\$ 1,982	\$ (582)	\$ -	\$ (582)
			202112	\$ 1,575	\$ 1,815	\$ (240)	\$ -	\$ (240)
	4.	Qualified Business Income Deduction	202012	\$ 2,072	\$ 7,075	\$ (5,003)	\$ -	\$ (5,003)
			202112	\$ 10,474	\$ 11,103.00	\$ (629)	\$ -	\$ (629)
	5.	Retirement Savings Credit	202012	\$ 828	\$ -	\$ 828	\$ -	\$ 828
	6.	Self Employment Tax	202012	\$ 2,800	\$ 3,964	\$ 1,164	\$ -	\$ 1,164
			202112	\$ 3,150	\$ 3,629.00	\$ 479	\$ -	\$ 479
	7.	Earned Income Credit	202012	\$ 860	\$ -	\$ (860)	\$ -	\$ (860)
	8.	Delq - IRC 6651 (a) (2)	202012	\$ -	\$ 780.80	\$ 780.80	\$ -	\$ 780.80
	9.	Delq - IRC 6651 (a) (1)	202012	\$ -	\$ 1,098.00	\$ 1,098.00	\$ -	\$ 1,098.00
	10.	Accuarcy - IRC 6662	202012	\$ -	\$ 1,013.80	\$ 1,013.80	\$ -	\$ 1,013.80

Appeals Preliminary Determination

Non-disputed items: The government proposes several adjustments that have not been disputed by the taxpayers. Non-disputed items should be sustained.